

## 1 HOUSE BILL NO. 652

2 INTRODUCED BY D. MCALPIN

3  
4 A BILL FOR AN ACT ENTITLED: "AN ACT PROHIBITING THE PRACTICE COMMONLY KNOWN AS  
5 INSURANCE STUFFING BY SPECIFYING WHEN CORPORATIONS MAY PROPERLY TAKE A  
6 DIVIDENDS-RECEIVED DEDUCTION FOR DIVIDENDS RECEIVED FROM INSURANCE COMPANIES;  
7 SPECIFYING HOW TO CALCULATE THE APPROPRIATE DIVIDENDS-RECEIVED DEDUCTION IN THOSE  
8 CIRCUMSTANCES; DISREGARDING THE PERMANENT DEFERRAL OF GAIN RECOGNITION FOR CERTAIN  
9 TRANSACTIONS; AUTHORIZING THE DEPARTMENT OF REVENUE TO INCLUDE IN THE GROSS INCOME  
10 THE TAXPAYER'S PRO RATA SHARE OF ANY OF THOSE INSURERS' CURRENT EARNINGS AND PROFITS  
11 IN THAT TAXABLE YEAR; PROVIDING A SAFE-HARBOR AND ALLOWING A CORPORATION TO  
12 DEMONSTRATE A LEGITIMATE BUSINESS PURPOSE FOR CERTAIN TRANSACTIONS; AND PROVIDING  
13 AN IMMEDIATE EFFECTIVE DATE AND A RETROACTIVE APPLICABILITY DATE."

14

15 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

16

17 NEW SECTION. **Section 1. Definitions.** For the purposes of [sections 1 through 6], unless otherwise  
18 required by the context, the following definitions apply:

19 (1) "Capitalization percentage" means the appropriate percentage established in [section 2].

20 (2) "Combined reporting group" means those corporations whose income is required to be included in  
21 the same combined report pursuant to 15-31-301 or 15-31-322.

22 (3) "Commonly controlled group" means a parent corporation and any one or more corporations or  
23 chains of corporations connected through stock ownership or constructive ownership with the parent if:

24 (a) the parent owns stock with more than 50% of the voting power of at least one corporation; and

25 (b) stock cumulatively representing more than 50% of the voting power of each of the corporations,  
26 except the parent, is owned by the parent, one or more corporations described in subsection (3)(a), or one or  
27 more other corporations that satisfy the conditions of this subsection (3)(b), if applicable.

28 (4) "Direct written premiums" means amounts written by an insurance company in consideration for  
29 insurance and annuity contracts issued to policyholders.

30 (5) "Dividend" means, for purposes of calculating the dividends-received deduction for any tax year

1 described in [section 2], the total amount of qualified dividends allowed as a deduction for federal income tax  
2 purposes received by the corporation from the insurer corporation.

3 (6) "5-year average" means the aggregate net written premiums or total income, as the case may be,  
4 over the 5 immediately preceding calendar or fiscal years, divided by five. If an insurance company in the  
5 commonly controlled group has been in existence for fewer than 5 years, its aggregate net written premiums and  
6 total income must each be multiplied by five and divided by the number of years of its existence. If an insurance  
7 company does not have a regulatory filing requirement, the period covered is the fiscal year used for the  
8 insurance company's financial statements. The use of either the calendar year or fiscal year that is used for the  
9 determination of the first tax year 5-year average is considered an accounting method under [sections 1 through  
10 6] and may be changed in subsequent tax years only with the written consent of the department.

11 (7) (a) "Investment income" means an insurance company's earnings from its investment portfolio,  
12 including interest, dividends, realized gains or losses, and rent, that unless otherwise provided in subsections  
13 (7)(b) through (7)(d), is required to be reported in an insurer's statutory annual statement in accordance with the  
14 annual statement instructions and accounting practices and procedures manual promulgated by the national  
15 association of insurance commissioners.

16 (b) Except for reinsurance transactions, realized gains or losses do not include losses incurred in  
17 transactions with a person that is a member of the taxpayer's or the insurance company's commonly controlled  
18 group.

19 (c) Investment income does not include dividends from a person that is a member of the commonly  
20 controlled group. Intercompany dividends that have been eliminated from investment income as would be  
21 required to be reported in the statutory annual statement in accordance with the annual statement instructions  
22 and accounting practices and procedures manual promulgated by the national association of insurance  
23 commissioners may not again be eliminated for this purpose.

24 (d) Investment income does not include income included in the taxpayer's combined report filed in  
25 accordance with this chapter.

26 (8) "Insurer" has the meaning provided in 33-1-201.

27 (9) (a) "Net income attributable to investment income" means net income of the insurer multiplied by a  
28 ratio, the numerator of which is the insurer's gross investment income from interest, dividends (other than  
29 dividends from members of the taxpayer's commonly controlled group), rent, and realized gains or losses, and  
30 the denominator of which is the insurer's gross income (other than dividends from members of the taxpayer's

1 commonly controlled group) from all sources.

2 (b) For the purposes of this definition, if an insurer is required to file a statutory annual statement  
3 pursuant to the annual statement instructions and accounting practices and procedures manual promulgated by  
4 the national association of insurance commissioners, "net income" means net income required to be reported in  
5 the insurer's statutory annual statement.

6 (10) (a) "Net written premiums" means direct written premiums plus premiums from reinsurance  
7 assumed, less premiums ceded to a reinsurance company, as would be required to be reported in an insurer's  
8 statutory annual statement in accordance with the annual statement instructions and accounting practices and  
9 procedures manual promulgated by the national association of insurance commissioners.

10 (b) Net written premiums from life insurance contracts are determined by multiplying the net written  
11 premiums received, assumed, or ceded by 1.3.

12 (c) Net written premiums from financial guaranty insurance contracts are determined by multiplying the  
13 net written premiums received, assumed, or ceded by the lesser of 2.3 or an amount that would cause the ratio  
14 of the 5-year average net written premiums for all financial guaranty insurance companies in the commonly  
15 controlled group to the 5-year average total income for all financial guaranty insurance companies in the  
16 commonly controlled group to be equal to the applicable capitalization percentage.

17 (11) "Premiums from reinsurance assumed" means amounts received or accrued by an insurance  
18 company in consideration for liabilities it assumes from another insurance company.

19 (12) "Qualified dividend" means a dividend received by a corporation during the tax year from a  
20 corporation that is an insurer, whether or not the insurer is engaged in business in Montana, if at the time of each  
21 dividend payment at least 80% of each class of stock of the insurer was owned, directly or indirectly, by the  
22 corporation receiving the dividend.

23 (13) "Total income" means net written premiums plus investment income.  
24

25 **NEW SECTION. Section 2. Reduction of dividends received by corporations -- capitalization**  
26 **percentage.** (1) For the purposes of calculating the dividends-received deduction allowed for Montana purposes,  
27 the amount of dividends must be multiplied by the appropriate capitalization percentage determined under  
28 subsections (2) through (4).

29 (2) If the ratio of the 5-year average net written premiums for all insurance companies in a commonly  
30 controlled group to the 5-year average total income for all insurance companies in the commonly controlled group

1 for the tax year is greater than or equal to 60%, then the capitalization percentage is 100%.

2 (3) If the ratio of the 5-year average net written premiums for all insurance companies in a commonly  
3 controlled group to the 5-year average total income for all insurance companies in the commonly controlled group  
4 for the tax year is less than 60% but greater than 10%, then the capitalization percentage is equal to the following  
5 fraction, expressed as a percentage:

6 (a) the numerator is the 5-year average net written premiums for the tax year; and

7 (b) the denominator is 60% of the 5-year average total income for that tax year.

8 (4) If the ratio of the 5-year average net written premiums for all insurance companies in a commonly  
9 controlled group to the 5-year average total income for all insurance companies in the commonly controlled group  
10 for the tax year is 10% or less, then the capitalization percentage is 0%.

11  
12 **NEW SECTION. Section 3. Deductions not allowed for certain expenses.** (1) A deduction is not  
13 allowed for any expense under subsection (2) that is paid or incurred to an insurer if the insurer is a member of  
14 the taxpayer's commonly controlled group and the amount paid or incurred would constitute income to the insurer  
15 if the insurer were subject to the Montana income or franchise tax.

16 (2) (a) The following interest amounts payable to an insurer in the same commonly controlled group are  
17 disallowed:

18 (i) interest paid or incurred to an insurer in the taxpayer's commonly controlled group with respect to  
19 indebtedness, other than qualified marketable debt instruments, the principal amount of which is attributable to  
20 a contribution of money by a noninsurer member of the taxpayer's commonly controlled group to the capital of  
21 an insurer member of that group, including the principal amount of a loan arising from a direct or indirect transfer  
22 of money from that contribution to capital from one insurer to another insurer of the same commonly controlled  
23 group;

24 (ii) interest paid or incurred to an insurer with respect to a note or other debt instrument, other than  
25 qualified marketable debt instruments, contributed to the capital of an insurer with respect to its stock by a  
26 noninsurer member of the commonly controlled group;

27 (iii) interest paid or incurred within 5 years after the direct or indirect acquisition of the insurer by a  
28 member of the commonly controlled group, other than interest on qualified marketable debt instruments; and

29 (iv) interest paid or incurred during the tax year to any insurer in the commonly controlled group multiplied  
30 by the disqualifying percentage. The disqualifying percentage is an amount equal to 100% less the capitalization

1 percentage provided for in [section 2(2),(3), or (4)] for that tax year whether or not a dividend is paid or accrued.

2 (b) The following noninterest expenses are disallowed:

3 (i) expenses attributable to property formerly held by the taxpayer or a member of the taxpayers'  
4 commonly controlled group that was acquired by the insurer in a transaction in which gain was realized but not  
5 recognized, including any income deferred under [section 4], by the taxpayer or a member of its commonly  
6 controlled group;

7 (ii) expenses attributable to property purchased with the proceeds attributable to a contribution by a  
8 noninsurer member of the taxpayers' commonly controlled group to the capital of an insurer member of that  
9 group, including amounts attributable to a direct or indirect transfer of money from that contribution from one  
10 insurer to another insurer in the same group.

11 (3) Expenses that may be disallowed by more than one expense exclusion in subsection (2) may be  
12 included only in the exclusion that will result in the highest disallowance amount.

13 (4) For purposes of this section, the following definitions apply:

14 (a) "Publicly available debt instruments" means debt instruments available to the general public, including  
15 bonds, debentures, and negotiable instruments that are rated by a nationally recognized statistical rating  
16 organization, as that term is used in rule 15c3-1(c)(2)(vi)(F) under the Securities Exchange Act of 1934, in one  
17 of its generic rating categories that signifies investment grade.

18 (b) "Qualified marketable debt instruments" means publicly available debt instruments of all noninsurer  
19 members of the commonly controlled group issued, but only to the extent that the aggregate principal amount of  
20 publicly available debt instruments held by all insurer members of the commonly controlled group constitutes less  
21 than 10% of the total outstanding principal amount of publicly available debt instruments issued by all noninsurer  
22 members.

23  
24 **NEW SECTION. Section 4. Transfer of property to insurer -- rules.** (1) (a) Except as provided in  
25 subsection (1)(b), in connection with any exchange described in 26 U.S.C. 332, 351, 354, 356, or 361, when a  
26 taxpayer transfers property to an insurer, the insurer, for purposes of determining the extent to which gain is  
27 recognized on that transfer, is not, for the purposes of this section, considered a corporation.

28 (b) The provisions of subsection (1)(a) do not apply to any of the following types of transactions unless  
29 that transaction has the effect, either directly or indirectly, of transferring appreciated property from a taxpayer  
30 subject to tax under this chapter or a member of the taxpayer's combined reporting group, to an insurer:

- 1 (i) an exchange or transfer pursuant to 26 U.S.C. 368(a)(2)(D) or (a)(2)(E);
- 2 (ii) a transfer of stock in an 80%-owned insurer for the purpose of filing a consolidated tax return or for  
3 financial or regulatory reporting; or
- 4 (iii) a transfer or exchange of publicly owned stock of the parent corporation.
- 5 (c) (i) If a transaction described in subsection (1)(b) would qualify under that subsection except that the  
6 transaction has the effect, directly or indirectly, of transferring appreciated property from a taxpayer or a member  
7 of the taxpayer's combined reporting group, subject to tax under this chapter, to an insurer, then, if the property  
8 is used in the active trade or business of the insurer, subsection (2) applies to that transfer.
- 9 (ii) For purposes of this subsection (1)(c), "appreciated property" means property whose fair market value,  
10 as of the date of the transfer subject to this section, exceeds its adjusted basis as of that date.
- 11 (2) (a) If property subject to subsection (1)(a) or (6) is transferred to an insurer for use in the active  
12 conduct of a trade or business of the insurer, then any gain otherwise required to be recognized under subsection  
13 (1)(a) or (6) is deferred until the date that:
- 14 (i) the property is no longer owned by an insurer in the taxpayer's commonly controlled group or a  
15 member of the taxpayer's combined reporting group;
- 16 (ii) the property is no longer used in the active conduct of the insurer's trade or business or the trade or  
17 business of another member in the taxpayer's combined reporting group; or
- 18 (iii) the holder of the property is no longer held by an insurer in the commonly controlled group of the  
19 transferor or a member of the taxpayer's combined reporting group.
- 20 (b) Any of the events described in subsection (2)(a) must be treated as a disposition of the property  
21 under this subsection (2) irrespective of whether any other provision of this chapter or in the Internal Revenue  
22 Code would otherwise permit nonrecognition treatment of the transaction described in this subsection (2).
- 23 (c) An insurer that becomes a member of the taxpayer's commonly controlled group or a corporation that  
24 becomes a member of the taxpayer's combined reporting group as a result of a transaction referred to in this  
25 subsection (2) must be treated as a member of the taxpayer's commonly controlled group or a member of the  
26 taxpayer's combined reporting group at the time of the transfer for purposes of this subsection (2).
- 27 (d) For purposes of this subsection (2), stock of an insurance subsidiary constitutes property used in the  
28 active trade or business of the insurer.
- 29 (e) This subsection (2) does not apply to any property described by 26 U.S.C. 367(a)(3)(B).
- 30 (f) If the deferred gain required to be taken into account under this subsection (2) is business income

1 as defined in 15-31-302, the gain must be apportioned using the apportionment percentage for the tax year that  
2 the gain is required to be taken into account under this subsection (2). Except as provided in 15-31-312 and rules  
3 adopted to implement that section, for purposes of the sales factor for that tax year, the transaction giving rise  
4 to that gain must be treated as a sale occurring in the tax year the gain is taken into account. The amount of any  
5 gain required to be recognized under this subsection (2) upon any disposition described in this subsection (2)  
6 may not exceed the lesser of the deferred gain or the gain realized in the transaction in which gain is required  
7 to be recognized under this subsection (2).

8 (g) For purposes of computing the amount of gain required to be recognized under this subsection (2),  
9 appropriate adjustments may be made, pursuant to rules adopted by the department, to the basis of stock to  
10 reflect the disallowance of any expenses under [section 3(2)].

11 (3) The department may adopt rules providing for an annual reporting requirement in the form of a  
12 statement or other form, to be attached to the transferor taxpayer's return, regarding the current ownership of any  
13 property for which any gains were previously deferred pursuant to subsection (2). If the transferor taxpayer fails  
14 to provide information required by the department, the department may, in lieu of the year referred to in  
15 subsection (2)(f), require that the transferor taxpayer take those gains into account in the first tax year in which  
16 the current ownership of the property is not reported unless the property is still owned by the transferee and the  
17 failure to provide the information was due to reasonable cause and not willful neglect. If a taxpayer fails to satisfy  
18 the reporting requirements of this subsection, then a notice of proposed deficiency assessment resulting from  
19 adjustments attributable to gains previously deferred pursuant to subsection (2), with respect to which the  
20 reporting requirements were not satisfied, may be mailed to the taxpayer within 4 years from the date on which  
21 the reporting requirements are satisfied by the taxpayer.

22 (4) Unless otherwise provided by rules adopted by the department, a transfer by a taxpayer of an interest  
23 in a partnership to an insurer in a transaction described in subsection (1)(a) must be treated as a transfer to that  
24 insurer of the taxpayer's pro rata share of the assets of the partnership.

25 (5) (a) A distribution described by 26 U.S.C. 355 or 26 U.S.C. 356 as it relates to 26 U.S.C. 355 must be  
26 treated as an exchange under this section, whether or not the distribution is an exchange. This subsection (5)(a)  
27 does not apply to a distribution in which:

- 28 (i) the distributing corporation is an insurer; or  
29 (ii) the distributee is a person other than an insurer.

30 (b) For a distribution described in 26 U.S.C. 355 or 26 U.S.C. 356 as it relates to 26 U.S.C. 355 by a

1 taxpayer to an insurer, the department shall adopt rules regarding the recognition of gain to prevent the removal  
2 of gain inherent in property at the time of a transfer from taxation.

3 (6) For purposes of this section, a transfer of property to an insurer as a contribution to capital of that  
4 insurer by one or more persons who, immediately after the transfer, own, within the meaning of 26 U.S.C. 318,  
5 stock possessing at least 80% of the total combined voting power of all classes of stock of that insurer that are  
6 entitled to vote must be treated as an exchange of that property for stock of the insurer equal in value to the fair  
7 market value of the property transferred.

8 (7) (a) In the case of any liquidation to which 26 U.S.C. 332 applies, unless otherwise provided in rules  
9 adopted by the department:

10 (i) 26 U.S.C. 337(a) and (b)(1), do not apply if the 80% distributee is an insurer; and

11 (ii) if the distributor is an insurer, the distributee shall treat the distribution as a distribution from the  
12 insurer's earnings and profits.

13 (b) For purposes of subsection (7)(a)(ii), the distribution from earnings and profits must be treated as  
14 a dividend eligible for a deduction, to the extent otherwise provided in [section 2], as if it was actually distributed  
15 as a dividend.

16 (8) (a) Upon an adequate showing by a taxpayer that a transaction referred to in subsection (1) or (7)  
17 would not violate the purposes of this section to prevent the removal of gain inherent in property at the time of  
18 a transfer from taxation under this section, the department may grant relief from the application of this section.

19 (b) In a proceeding contesting the department's actions under this section, relief may be granted a  
20 taxpayer only upon a specific finding by the state tax appeal board or district court that the contested transfer did  
21 not remove gain inherent in property at the time of transfer from taxation under this section.

22

23 **NEW SECTION. Section 5. Includable in gross income.** (1) (a) The department may include in the  
24 gross income of the taxpayer or a member of the taxpayer's combined reporting group in that tax year the  
25 taxpayer's pro rata share or the pro rata share of a member of the taxpayer's combined reporting group of any  
26 of those insurers' current earnings and profits in that tax year, but not to exceed an amount equal to the specific  
27 insurer's net income attributable to investment income for that year minus that insurer's net written premiums  
28 received in that same tax year, if:

29 (i) for any tax year, an insurer is a member of a taxpayer's commonly controlled group;

30 (ii) the ratio of the 5-year average net written premiums to the 5-year average total income of all insurers

1 in the commonly controlled group is equal to or less than 0.10; and

2 (iii) the accumulation of earnings and profits of the insurers in the commonly controlled group had a  
3 substantial purpose of avoidance of taxes on, according to, or measured by income of this state or any other  
4 state.

5 (b) The amount included in gross income pursuant to subsection (1)(a) must be treated as a dividend  
6 received from an insurance company during the tax year, and to the extent applicable, [section 2] applies to that  
7 amount.

8 (2) To the extent that the amounts are included pursuant to subsection (1) in the gross income of a  
9 taxpayer or a member of the taxpayer's combined reporting group, those amounts may not again be considered  
10 as investment income in the application of the ratio in subsection (1)(a)(ii).

11 (3) (a) The amounts included in gross income under subsection (1) may not again be included in gross  
12 income when subsequent distributions are made to:

13 (i) the taxpayer or a member of the taxpayer's combined reporting group;

14 (ii) another taxpayer that acquires an interest in the stock of the taxpayer or a member of the taxpayer's  
15 combined reporting group with respect to which subsection (1) was applied; or

16 (iii) any successor or assign of the respective taxpayers or a member of the taxpayer's combined  
17 reporting group described in this subsection (3).

18 (b) For purposes of applying this subsection (3), distributions from an insurer are considered first made  
19 from amounts included under subsection (1).

20 (4) For purposes of this section, the terms "net written premiums", "5-year average net written  
21 premiums", and "5-year average total income" have the same meaning as applicable for [section 2], whether or  
22 not a dividend is actually received from any insurer member of the taxpayer's commonly controlled group in that  
23 tax year.

24 (5) For the purposes of this section, the taxpayer's pro rata share of the current earnings and profits of  
25 an insurer member of a commonly controlled group is the amount that would have been received as a dividend  
26 by the taxpayer or a member of the taxpayer's combined reporting group if:

27 (a) the insurer had directly distributed its current earnings and profits with respect to its stock held by  
28 the taxpayer or a member of the taxpayer's combined reporting group; and

29 (b) the insurer holds the stock of another insurer and all other insurer members of the taxpayer's  
30 commonly controlled group had distributed the same current earnings and profits with respect to their stock, in

1 the same tax year, until amounts were received as a dividend by the taxpayer or a member of the taxpayer's  
2 combined reporting group from an insurer member of the commonly controlled group.

3 (6) In the application of this section, amounts treated as a dividend received by a partnership are  
4 considered a dividend received by each partner that is a member of the commonly controlled group, either directly  
5 or through a series of tiered partnerships.

6 (7) The provisions of this section do not apply to an insurer involved in a proceeding under the Insurers  
7 Supervision, Rehabilitation, and Liquidation Act, Title 33, chapter 2, part 13, or any similar proceeding brought  
8 by any other state insurance commissioner.

9

10 **NEW SECTION. Section 6. Legitimate business purpose.** (1) If a taxpayer's ratio of the 5-year  
11 average net written premiums for all insurance companies in a commonly controlled group to the 5-year average  
12 total income for all insurance companies in the commonly controlled group for the tax year is greater than or equal  
13 to 60%, as determined under [section 2], then the provisions of [sections 1 through 6] do not apply.

14 (2) If a taxpayer's ratio of the 5-year average net written premiums for all insurance companies in a  
15 commonly controlled group to the 5-year average total income for all insurance companies in the commonly  
16 controlled group for the tax year is less than 60%, as determined under [section 2], and upon an adequate  
17 showing by a taxpayer that a transaction referred to in [sections 1 through 6] was entered into with a legitimate  
18 business purpose, the department may grant relief from the application of [sections 1 through 6].

19

20 **NEW SECTION. Section 7. Codification instruction.** [Sections 1 through 6] are intended to be codified  
21 as an integral part of Title 15, chapter 31, and the provisions of Title 15, chapter 31, apply to [sections 1 through  
22 6].

23

24 **NEW SECTION. Section 8. Severability.** If a part of [this act] is invalid, all valid parts that are severable  
25 from the invalid part remain in effect. If a part of [this act] is invalid in one or more of its applications, the part  
26 remains in effect in all valid applications that are severable from the invalid applications.

27

28 **NEW SECTION. Section 9. Effective date.** [This act] is effective on passage and approval.

29

30 **NEW SECTION. Section 10. Retroactive applicability.** [This act] applies retroactively, within the

1 meaning of 1-2-109, to tax years beginning after December 31, 2008.

2 - END -